

STATE CORPORATION COMMISSION

**REPORT ON AUDIT
FOR THE YEARS ENDED
JUNE 30, 2006 AND JUNE 30, 2007**



AUDIT SUMMARY

Our audit of the State Corporation Commission, for the two-year period ending June 30, 2007, found:

- proper recording and reporting of all transactions, in all material respects, in the Commonwealth Accounting and Reporting System and the Commission's accounting records;
- certain matters involving internal control and its operations necessary to bring to management's attention; and
- instances of noncompliance with applicable laws and regulations or other matters that are required to be reported.

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AUDIT FINDINGS AND RECOMMENDATIONS

Comply with Commonwealth Security Standards

The State Corporation Commission (Commission) should improve its Information Systems Security Program in order to minimize the risk of poor data integrity, potential data breach, and lack of availability of its sensitive and mission critical information. We recommend that the Commission address the following information security areas to comply with the Commonwealth's security standards:

- Establish a Security Awareness Training Program;
- Perform a Risk Assessment;
- Complete a Business Impact Analysis;
- Prepare Continuity of Operations and Disaster Recovery Plans; and
- Develop formally approved security policies and procedures as required by the Commonwealth's security standard, SEC 501.

During the past year, the Commission developed an in-depth information security strategic plan and included substantial dedicated funding in its spending plan through 2010. The Commission, actively working on the plan's implementation, has hired an Information Security Manager, contracted with a consultant to assess physical security at the central facility, and developed contingency plans for one of its mainframes. We recommend that management continue its progress in developing its Information Systems Security Program.

The Commission should ensure management allocates the time and resources necessary to complete a comprehensive information security program that meets industry best practices and incorporate the consultant's recommendations before they are outdated.

Timely Remove Employee Access to Commonwealth Statewide Systems

The Commission did not disable an employee's access timely to the Commonwealth's statewide accounting and payroll systems after separation from the agency. Specifically, management did not delete one employee's access to certify payroll and approve accounting transactions for almost two months after separation from the agency.

We recommend that the Commission develop specific policies that specify an acceptable length of time for system access removal. We also recommend that the Commission communicate and follow this process to ensure that management removes access in a timely manner.

Properly Complete Employment Eligibility Verification Forms

The Commission is not properly completing Employment Eligibility Verification forms (I-9) in accordance with guidance issued by the U.S. Citizenship and Immigration Services of the U.S. Department of Homeland Security. In our sample of 15 I-9 forms, we found the Commission incorrectly completed all 15 of the forms. We found the following errors during our review:

- Improperly completed the required information regarding the verification documents it reviewed for 13 employees;

- Inconsistently ensured employees were properly completing the Employee Information and Verification Section of the form. One employee did not correctly complete the citizenship section and two employees did not correctly date the form;
- Excluded the date of the first day of actual employment in the Certification section from all forms reviewed; and
- For four employees, the Commission did not have a complete I-9 form, which includes a listing of acceptable identification documentation.

The U.S. Department of Homeland Security regulates the process for completing the I-9 forms and failure to complete the forms properly can result in significant penalties to both the employee and employer. Because of the potential sanctions, we recommend that the Commission obtain training for its staff on the guidelines for completing I-9 forms. We also recommend the Commission develop and follow internal policies and procedures to ensure compliance with the U.S. Department of Homeland Security guidelines. Finally, we recommend that the Commission devise a plan of action in order to update all incorrect I-9 forms currently on file. The federal government has increased its enforcement efforts requiring employers to ensure that all new employees are legally entitled to work in the United States. This increased enforcement makes having an effective I-9 process in place more important.

Improve Firewall Controls

The Commission does not restrict network traffic through its firewall based on the principle of least privilege. The firewall also allows users from remote locations to connect to internal computers on the Commission's network using unencrypted protocols. Both of these vulnerabilities exist because of an incomplete firewall policy and increase the Commission's risk in regards to confidentiality, integrity, and availability of sensitive and mission critical data.

While the Commission has a firewall policy, it lacks certain elements that would improve the Commission's security posture. For example, the policy should include a requirement for periodic reviews of the firewall configuration file and the documentation of such reviews. In addition to periodic reviews, the Commission should consider implementing a requirement that remote connections into its network are encrypted and that all connections are configured based on the principle of least privilege.

We recommend that the Commission devote the necessary resources to re-evaluate its firewall policy and implement appropriate adjustments to strengthen its security program and posture. This effort also includes training the appropriate personnel that will implement the new policy requirements.

AGENCY HIGHLIGHTS

The Commission is an independent agency directed by three commissioners, each elected by the General Assembly for six-year terms. Each commissioner administers specific divisions and the commissioners annually rotate the chairmanship.

The Commission has both regulatory and non-regulatory divisions. The regulatory divisions monitor a number of industries, including utilities, state-chartered financial institutions, securities, retail franchising, insurance, and railroads. The Commission also serves as the Commonwealth's central filing office for corporations, limited partnerships, limited liability companies, business trusts, and Uniform Commercial Code filings.

The non-regulatory divisions provide administrative and legal support to the regulatory divisions. The Commission funds its operations from certain regulatory assessments and fees set by statute. The Commission also collects revenues for the General Fund, other special revenue funds, localities, and other state entities.

The regulatory and non-regulatory divisions are show below.

Regulatory Divisions:

Insurance
Securities and Retail Franchising
Financial Institutions
Public Service Taxation
Public Utility Accounting
Communications
Energy Regulation
Economics and Finance
Utility and Railroad Safety
Clerk of the Commission

Non-Regulatory Divisions:

Commissioners' Offices
General Counsel
Hearing Examiners
Commission Comptroller
Information Resources
Human Resources
Information Technology

The Commissioners' Offices include the Chief Administrative Officer, Counsel to the Commission, Internal Audit, and Information Security.

Regulatory Divisions

Bureau of Insurance

The Bureau of Insurance (Insurance) regulates over 1,500 insurance companies and 105,000 agents authorized to operate in Virginia. Insurance examines the financial affairs of each domestic (Virginia-based) insurance company at least once every five years, and requires annual statements from foreign (based outside of Virginia) and alien (based outside of the United States) insurance companies doing business in Virginia. Insurance also assists the public in resolving disputes with insurance companies.

Insurance collects a gross premium tax from insurance companies, which totaled \$374.0 million in General Fund revenue in fiscal year 2006 and \$385.2 million in fiscal year 2007. In addition, Insurance collected \$24.4 million in fiscal year 2006 and \$25.7 million in fiscal year 2007 in special revenue comprised of assessments and license, application, appointment, and other fees. Insurance also collects an assessment from property and casualty insurance companies, which it transfers to the Department of Fire Programs; this totaled \$25.9 million in fiscal year 2006 and \$27.4 million in fiscal year 2007.

In addition, Insurance collects special assessments for the Virginia State Police to investigate insurance fraud. Each licensed insurer doing business in the Commonwealth, by writing any type of property and casualty insurance, except title insurance, pays a special assessment fee equal to a percentage of its direct gross premium income during the preceding calendar year. Insurance can impose a late payment penalty of ten percent of the assessment and retains a portion of the special assessment to cover its administrative expenses. Insurance transferred \$5.1 million in fiscal year 2006 and \$5.2 million in fiscal year 2007 to the Virginia State Police.

Insurance also receives uninsured motorist fees collected by the Department of Motor Vehicles (Motor Vehicles). In accordance with the Code of Virginia, Insurance distributes these funds to the insurance companies who write automobile liability insurance. Motor Vehicles transferred uninsured motorist fees to Insurance totaling \$7.2 million in fiscal year 2006 and \$7.1 million in fiscal year 2007.

Division of Securities and Retail Franchising

The Division of Securities and Retail Franchising (Security and Retail Franchising) regulates security brokers and investment advisors in Virginia, registers security industry professionals, and investigates complaints about particular securities, practices, or events. Security and Retail Franchising also registers franchises and trademarks in Virginia and investigates any reports of securities or franchising law violations or misconduct. This division determines what is required under the Virginia Securities Act to register public offerings and conducts private security offerings, reviews offering documents, and approves offers and sales of securities in Virginia. Security and Retail Franchising collected \$8.6 million in special revenue during fiscal year 2006 and \$9.2 million in fiscal year 2007.

Bureau of Financial Institutions

The Bureau of Financial Institutions (Financial Institutions) regulates and examines state-chartered banks, trust companies, savings and loans, and credit unions. Financial Institutions also provides licenses and examines mortgage lenders and brokers, and licenses and regulates money order sellers, consumer finance companies, industrial loan association's payday lenders, and credit counseling agencies. Financial Institutions collects revenue from these entities for application fees, license fees, annual assessment fees, examination fees, and investigation fees, which totaled \$11.0 million in fiscal year 2006 and \$12.4 million in fiscal year 2007.

Division of Public Service Taxation

The Division of Public Service Taxation (Public Service Taxation) collects state taxes and fees on revenues and services of public service companies (e.g., electricity, water, and other power companies; telecommunications companies; and railroads). Public Service Taxation collects taxes on electricity and natural gas based on a consumption tax imposed on the customers. Public Service Taxation also determines and certifies the assessed value of utility company's property for local property taxation. In fiscal year 2006, the Public Service Taxation collected \$85.0 million in General Fund revenue and \$20.7 million in special revenue. In fiscal year 2007, Public Service Taxation collected \$82.7 in General Fund revenue and \$17.5 million in special revenue.

Division of Public Utility Accounting

The Division of Public Utility Accounting provides the Commissioners with information and analysis on utilities and other entities' accounting and financial information. The Commissioners use this information when considering utility cases involving rates and services; affiliate transactions, mergers and acquisitions;

certificates of public convenience and necessity; alternative regulatory plans; and the restructuring of utility markets.

Division of Communications

The Division of Communications (Communications) regulates Virginia's telecommunications industry (other than the federally regulated cellular and wireless communications). Communications reviews rates and costs, evaluates telephone companies' performance, investigates consumer complaints regarding communications service, and oversees the implementation of telecommunications market competition.

Division of Energy Regulation

The Division of Energy Regulation (Energy Regulation) regulates Virginia's investor-owned water and sewer, electric, and natural gas utilities, and member-owned electric cooperatives. Energy Regulation's responsibilities include reviewing rate applications filed by investor-owned utilities and member-owned cooperatives, monitoring utility construction projects, and responding to consumer complaints regarding electric, gas, and water and sewer utilities under the Commission's jurisdiction. The focus of electricity regulation is shifting from setting rates, to implementing the restructuring law under the guidance of the General Assembly.

Division of Economics and Finance

The Division of Economics and Finance advises the Commissioners on economic and finance issues related to public utilities, conducts research, and develops special studies and forecasts.

Division of Utility and Railroad Safety

The Division of Utility and Railroad Safety (Utility and Railroad Safety) works to ensure safe operation of railroads within the Commonwealth by inspecting facilities, tracks, and equipment. To promote natural gas and hazardous liquid pipeline safety, Utility and Railroad Safety conducts pipeline facilities inspections, reviews records, and investigates incidents. Utility and Railroad Safety also investigates all reports of probable violations of the Underground Utility Damage Prevention Act; this division provides free training relative to the Underground Utility Damage Prevention Act to stakeholders, conducts public education campaigns, and promotes partnership among various parties to further underground utility damage prevention in Virginia.

The Clerk of the Commission

The Clerk is the Commission's official custodian of judicial and administrative records. The Clerk's Office also serves as the central filing office for Uniform Commercial Code financing statements and federal tax liens as well as for thousands of corporations, partnerships, and limited liability companies doing business in Virginia. The Clerk's Office collects various fees from corporations, partnerships, and limited liability companies that register with the Commission. In fiscal year 2006, the Clerk's Office collected \$6.6 million in General Fund revenue and \$43.9 million in special revenue. In fiscal year 2007, the Clerk's Office collected \$6.4 million in General Fund revenue and \$46.3 million in special revenue.

Non-Regulatory Divisions

The non-regulatory divisions provide the Commission with administrative and legal support.

FINANCIAL INFORMATION

The Commission funds its operations from certain regulatory assessments and fees set by statute, and records this activity primarily in four special revenue funds. Depending on the revenue source, the Commission collects revenue annually, quarterly, or monthly. The Commission maintains a cash balance in these special revenue funds as a reserve to prevent a large fluctuation in rates. The Commission also collects a majority of its revenues for the General Fund. In fiscal year 2007, General Fund revenues accounted for 76 percent of the Commission's total collections. The following table shows the total revenues the Commission collected by fund for fiscal years 2006 and 2007.

Table 1

<u>Revenue by Fiscal Year and Fund</u>		
<u>Fund</u>	<u>2007</u>	<u>2006</u>
General	\$474,346,812	\$465,718,379
Special revenue	139,131,979	135,125,359
Trust and agency	4,667,157	4,999,278
Dedicated special revenue	6,989,327	6,707,985
Federal trust	<u>347,430</u>	<u>368,422</u>
Total	<u>\$625,482,705</u>	<u>\$612,919,423</u>

The Department of Planning and Budget establishes an original expense budget based on the prior biennium budget amount, and adjusts for certain items. The following schedule compares the Commission's original and adjusted budgets with actual expenses.

Table 2

<u>Budget to Actual Operating Expenses by Fiscal Year and Fund</u>			
<u>Fiscal Year 2007</u>			
	<u>Original Budget</u>	<u>Final Budget</u>	<u>Actual Expenses</u>
Special revenue	\$84,088,241	\$77,393,412	\$61,452,909
Trust and agency	4,657,400	7,625,956	7,538,771
Dedicated special revenue	828,500	1,028,500	962,000
Federal grants	<u>-</u>	<u>9,852</u>	<u>9,527</u>
Total	<u>\$89,574,141</u>	<u>\$86,057,720</u>	<u>\$69,963,207</u>
<u>Fiscal Year 2006</u>			
	<u>Original Budget</u>	<u>Final Budget</u>	<u>Actual Expenses</u>
Special revenue	\$80,059,864	\$82,020,483	\$67,033,223
Trust and agency	11,200,000	11,200,000	7,686,056
Dedicated special revenue	1,411,937	1,626,651	1,039,399
Federal grants	<u>-</u>	<u>395,203</u>	<u>394,238</u>
Total	<u>\$92,671,801</u>	<u>\$95,242,337</u>	<u>\$76,152,916</u>

In fiscal year 2007, the original special revenue budget decreased by \$6.7 million because the General Assembly transferred revenue collection responsibilities for the Dual Party Relay Services program to the Department of Taxation. Actual expenses for fiscal years 2006 and 2007 were less than the final budget because the Commission delayed several planned internal information technology, security, and facility projects. The Commission hired a consulting firm to review their operations and management delayed projects to await the results of this report. As a result of this study, the Commission prepared a long-term plan for the delayed projects and created new administrative positions to oversee administrative support functions and the newly created Information Security Office.

Payroll costs, including fringe benefits, accounted for approximately 65 percent, or \$45 million, of the Commission's total expenses during fiscal year 2007. During fiscal year 2007, the Commission spent \$13.9 million, or 20 percent, on contractual services and an additional \$7.7 million, or 11 percent, on transfer payments. Table 3 details the Commission's operating expenses by major expense category.

Table 3

Operating Expenses by Fiscal Year and Major Category

	<u>2007</u>	<u>2006</u>
Personal services	\$45,249,446	\$46,198,367
Contractual services	13,934,142	18,771,852
Supplies and materials	480,737	469,360
Transfer payments	7,709,222	7,885,007
Rent and other continuous charges	849,371	809,800
Equipment	<u>1,740,289</u>	<u>2,018,530</u>
Total	<u>\$69,963,207</u>	<u>\$76,152,916</u>

Under the contractual services category, the Commission paid the Dual Party Relay Services vendor, AT&T, for directory services provided to Virginia citizens who are hearing impaired or visually handicapped. These payments totaled \$7.9 million in fiscal year 2006. In fiscal year 2007, the Commission paid only \$3.7 million to AT&T since responsibilities for the program transferred to the Department of Taxation.

The Commission paid \$7.1 million in fiscal year 2007 and \$7.2 million in fiscal year 2006 to insurance companies for the uninsured motorist program. These uninsured motorist payments comprise approximately 90 percent of the total Commission's transfer payments.



Commonwealth of Virginia

Walter J. Kucharski, Auditor

**Auditor of Public Accounts
P.O. Box 1295
Richmond, Virginia 23218**

June 7, 2008

The Honorable Timothy M. Kaine
Governor of Virginia
State Capital
Richmond, Virginia

The Honorable M. Kirkland Cox
Chairman, Joint Legislative Audit
and Review Commission
General Assembly Building
Richmond, Virginia

We have audited the financial records and operations of the **State Corporation Commission** for the two-year period ended June 30, 2007. We conducted this performance audit in accordance with generally accepted Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Audit Objectives

Our audit's primary objectives were to evaluate the accuracy of recorded financial transactions on the Commonwealth Accounting and Reporting System and in the Commission's accounting records, review the adequacy of the Commission's internal controls, test for compliance with applicable laws and regulations, and review corrective actions of audit findings from prior year reports.

Audit Scope and Methodology

The Commission's management has responsibility for establishing and maintaining internal control and complying with applicable laws and regulations. Internal control is a process designed to provide reasonable, but not absolute, assurance regarding the reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations.

We gained an understanding of the overall internal controls, both automated and manual, sufficient to plan the audit. We considered materiality and control risk in determining the nature and extent of our audit procedures. Our review encompassed controls over the following significant cycles, classes of transactions, and account balances.

- Revenue
- Payroll expenses
- Operating expenses
- Systems security

We performed audit tests to determine whether the Commission's controls were adequate, had been placed in operation, and were being followed. Our audit also included tests of compliance with provisions of applicable laws and regulations. Our audit procedures included inquiries of appropriate personnel and observation of the Commission's operations. We inspected documents including reconciliations, vouchers, contracts, timesheets, and monthly division revenue reports. We reviewed the applicable sections of the Code of Virginia and the 2007 Virginia Acts of Assembly. We tested transactions and performed analytical procedures, including budgetary and trend analyses.

Conclusions

We found that the Commission properly stated, in all material respects, the amounts recorded and reported in the Commonwealth Accounting and Reporting System, and in the Commission's accounting records. The Commission records its financial transactions on the cash basis of accounting, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America. The financial information presented in this report came directly from the Commonwealth Accounting and Reporting System.

We noted certain matters involving internal control and its operation and compliance with applicable laws and regulations that require management's attention and corrective action. These matters are described in the section entitled "Audit Findings and Recommendations."

The Commission is in the process of taking corrective action with respect to the audit finding titled "Commonwealth Security Standards" reported in the prior year.

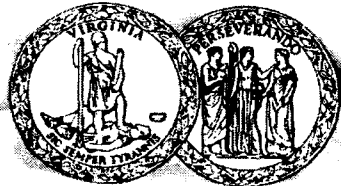
Exit Conference and Report Distribution

We discussed this report with management on June 12, 2008. Management's response has been included at the end of this report.

This report is intended for the information and use of the Governor and General Assembly, management, and the citizens of the Commonwealth of Virginia and is a public record.

AUDITOR OF PUBLIC ACCOUNTS

COMMONWEALTH OF VIRGINIA



JUDITH WILLIAMS JAGDMANN
CHAIRMAN

MARK C. CHRISTIE
COMMISSIONER

JOEL H. PECK
CLERK OF THE COMMISSION
P.O. BOX 1197
RICHMOND, VIRGINIA 23218-1197

STATE CORPORATION COMMISSION

June 16, 2008

Mr. Walter J. Kucharski
Auditor of Public Accounts
James Monroe Building
101 N. 14th Street
Richmond, Virginia 23219

Dear Mr. Kucharski:

The State Corporation Commission (Commission) appreciates the time and effort that your staff devoted to the review of the Commission's financial records and operations for fiscal years ending 2006 and 2007. Your staff's comments and recommendations are appreciated. Our response to the each of the APA findings is set out below.

Comply with Commonwealth Security Standards

The Commission agrees that its Information System Security Program needs improvement and significant steps have already been taken to strengthen data security. We appreciate the recognition in the audit report of our progress during the past year to develop an in-depth Information Security Strategic Plan as well as noting in the report the work which has been completed at this time. The strategic plan contains "best practice" goals and objectives to achieve the level of security to protect the integrity of Commission data and information systems. Implementation of the plan will occur over the next two and one half years.

Timely Remove Employee Access to Commonwealth Statewide Systems

While the Commission has documented procedures for system access termination, one employee's access to systems was not timely removed. It is recognized that existing procedures should be modified to include acceptable timeframes for system access removal. The recommended changes and the new process will be operational by June 30, 2008.

Properly Complete Employment Eligibility Verification Forms

Steps have been taken to correct the 15 Employment Eligibility Forms, I-9 included in the audit findings and staff has reviewed I-9 forms of all new hires over the last two years. The Commission has modified its procedures to improve future compliance with Federal guidelines by creating a quality review step in the process. Staff recently attended the I-9 training program offered by the Department of Accounts.

Improve Firewall Controls

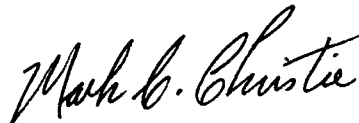
The Commission agrees with the report finding in this area and firewall policies have already been implemented to restrict traffic through the firewall based on the least privilege principle. Stronger protocols have also been instituted for Commission remote users who connect to the network. As the report recommends, procedures have been implemented to periodically review the firewall configuration file.

We appreciate the opportunity to review and comment on the draft Audit Report as well as staff's attention to our comments throughout the audit engagement.

Sincerely,

A handwritten signature in black ink, appearing to read "Judith Williams Jagdmann".

Judith Williams Jagdmann, Chairman

A handwritten signature in black ink, appearing to read "Mark C. Christie".

Mark C. Christie, Commissioner

STATE CORPORATION COMMISSION

COMMISSIONERS

Judith Williams Jagdmann, Chairman

Mark C. Christie